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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 758.

NORTH AMERICAN BOND TRUST, City Bank Farmers Trust Company, Trustee,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

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No. .

NORTH AMERICAN BOND TRUST, City Bank Farmers Trust Company, Trustee,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

The petitioner prays that a writ of certiorari issue to review the judgment (R. 211) of the United States Circuit Court of Appeals for the Second Circuit entered in this case on August 30, 1941.

Summary Statement of Matter Involved.

This is an income tax case which reached the Circuit Court of Appeals from the Board of Tax Appeals. The sole question in the case is whether the petitioner, which is an investment trust, the portfolio of which consists solely of bonds, no portion of the proceeds of which can be reinvested by the Trustee, was, during the fiscal year ended August 31, 1936, an association taxable as a corporation under the income tax laws.

Opinions Below.

The Memorandum Opinion of the Board of Tax Appeals (R. 166) is not reported. Each of the three Judges of the Circuit Court of Appeals filed separate opinions (R. 197, 208, 210) and the opinions are reported at 122 Fed. (2d) 545.

Jurisdiction.

Jurisdiction to issue the writ prayed for is vested in this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925. The judgment of the Circuit Court of Appeals was entered on August 30, 1941 (R. 211).

Questions Presented.

(1) Was the petitioner during the fiscal year ended August 31, 1936 an association taxable as a corporation?

(2) Did the petitioner during said fiscal year resemble a corporation in form and procedures?

(3) Was the petitioner during said fiscal year an enterprise for the transaction of business?

(4) Assuming *arguendo* that the activities of the Depositor (sponsor of the Trust), with relation to the petitioner during said fiscal year, constituted the carrying on of a business enterprise, can the petitioner be held to be an association taxable as a corporation solely because of such activities—over which the petitioner had, and by the terms of the Trust Agreement could have, no control?

(5) Is Article 801-2 of Regulations 86, set forth in the Appendix, in so far as it purports to include within the term association "an 'investment trust' (whether of the fixed or the management type), * * * which is not within the meaning of the Act, a trust * * *" invalid, as applied to the petitioner, because it exceeds the will of Congress in enacting the Revenue Act of 1934 and hence is an attempt by the respondent to make law, in violation of Section 8 of Article I of the Constitution?

(6) Did the Circuit Court of Appeals make independent findings of fact, inconsistent with the findings of the Board of Tax Appeals in violation of the rule established by this Court that the findings of fact made by the Board of Tax Appeals are binding if there is substantial evidence to support them?

Statutes and Regulations Involved.

The statute involved is the Revenue Act of 1934 c. 277, 48 Stat. 680:

> "Sec. 201. *Definitions.* (a) When used in this Act—* * *
>
> (2) the term 'corporation' includes associations, joint stock companies, and insurance companies.
>
> * * *
>
> (U. S. C. Title 26, Sec. 1696)."

The regulations involved are set forth in the Appendix.

Facts.

The petitioner was created under a Trust Agreement dated as of September 1st, 1932, and exists under said Trust Agreement, as amended September 14, 1933, by and between Distributors Group, Incorporated, as Depositor, City Bank Farmers Trust Company, as Trustee, and the registered holders from time to time of Trust Certificates, representing Interests in the petitioner, to be issued under the Agreement (R. 22-82). All references to the Trust Agreement are to the agreement as amended. The effect of the Trust Agreement was to establish an investment vehicle of the type known as an open-end investment trust. The portfolio can contain only cash and bonds conforming to certain standards designated in the Agreement (R. 23-25). Detailed specifications are set forth concerning the eligibility of bonds to be deposited with and held by the Trustee (R. 39-46). In addition to the Interests created upon the establishment of the petitioner, the Depositor for the account of others, may, from time to time, in accordance with the terms of the Trust Agreement, create additional Interests, by delivering to the Trustee cash and a bond or bonds, accompanied by the required certificate as to the eligibility of such bond or bonds for deposit, and the Trustee must accept the cash and the bond or bonds and add them to the trust *res* (R. 24-27). The Trustee has no control over such activity of the Depositor.

Under the Trust Agreement, the Depositor may, from time to time, certify to the Trustee bonds which, in its opinion, from the viewpoint of an investment to be held until the maturity of the bonds or the termination of the Trust, whichever shall first occur, and solely for the purpose of preserving the quality

of the investment, should be eliminated. The Trustee is obliged to follow the opinion of the Depositor on this point if it is supported by the opinion of an independent investment counsel, but if such investment counsel disagrees with the Depositor, the Trustee may exercise its own discretion (R. 36-37).

Whenever any bonds held by the Trustee as a part of the deposited property are called for payment or mature, the Trust Agreement requires that the proceeds thereof, together with the proceeds of any bonds eliminated as aforesaid, must be added to "currently distributable funds" and distributed to the certificate holders with the next semi-annual distribution of income (R. 79-80).

Under no circumstances may the proceeds of called, matured or eliminated bonds be reinvested.

The Trust Agreement provides that the Trust is to continue until August 31, 1952 but that it may be terminated earlier if all the Certificates are theretofore surrendered for cash (R. 51-52). A Certificate holder may surrender his Certificate at any time and receive in cash from the Trustee a sum of money equal to his proportionate share of the market value of the deposited property (R. 52-55).

The Agreement states that it is intended to be construed under and governed by the laws of New York and that it is intended to create the relationship of trustee and *cestuis que trustent* and not a partnership, association, bailment or any form of legal relation other than that of a true trust (R. 66).

No meetings of certificate holders are held. The Trust has never had a minute book or seal and has never had any officers or directors or similar governing body (R. 19).

During the fiscal year ended August 31, 1936 the Depositor deposited bonds with the Trustee in the

principal amount of $1,621,000 upon the creation of 2,202 new Interests. Certificate holders liquidated 138 Interests during the year. At the end of the year there were 9,312 Interests outstanding having a book value of $6,266,340.77 held by 2,102 registered holders (R. 18). 30 Certificates were transferred by operation of law and death; over 500 Certificates were transferred by the Depositor (R. 19).

For the taxable years prior to that ended August 31, 1936, the Trustee filed income tax returns on Form 1041 on the basis that the entity was taxable as a trust (R. 16). By a letter dated September 22, 1933, the Commissioner of Internal Revenue notified the Trustee that the entity was then classified as a trust but that this ruling was subject to change if further developments in the law appeared to warrant it (R. 83-84). The ruling was reversed thereafter and in a letter dated October 17, 1935 the Commissioner notified counsel for the Trustee that beginning after the close of the 1935 taxable year the petitioner would be classed as an association (R. 85-86). Thereafter, the Trustee filed an income tax return for the current year on Form 1120, attaching a rider disclaiming liability for the taxes applicable to associations (R. 89, 97). When the Commissioner notified the Trustee of a proposed deficiency, it petitioned the Board of Tax Appeals for redetermination thereof (R. 3-11). Thereafter, the Trustee, without terminating the proceedings in the Board of Tax Appeals, paid the amount of the tax and interest alleged to be due (R. 21).

The Board held that the Commissioner had erred in classifying the Trust as an association rather than a strict trust (R. 178).

The Court below reversed the Board of Tax Appeals (R. 211).

Rulings Below.

In its Memorandum Opinion, the Board of Tax Appeals said (R. 177):

> "We think our decision must follow that in Chase National Bank, Trustee, 41 BTA 430. The facts are substantially similar to those in this proceeding."

The Board further said (R. 178):

> "Here, since the trust corpus was 'fixed' and the possibilities and the limits of the exercise of discretion by the Trustee and Depositor so negligible, we think that 'Unlike the organization in *Morrissey* v. *Commissioner, supra*, petitioners' object was only "to hold and conserve particular property, with incidental powers, as in the traditional type of trusts". They were not "created and maintained as a medium for the carrying on of a business enterprise".' *Chase National Bank, Trustee, supra.*"
>
> "Without examining the petitioning trust further, the determination of the Commissioner, classifying it as an association, is reversed."

In other words, the Board, having determined that the petitioner was not a medium for the carrying on of a business enterprise, did not find it necessary to inquire whether it employed corporate forms and procedures,—which, under *Morrissey* v. *Commissioner*, 296 U. S. 344, must be used if the entity is to be held an association taxable as a corporation.

The Circuit Court of Appeals for the Second Circuit in *Commissioner of Internal Revenue* v. *Chase National Bank*, 122 Fed. (2d) 540, decided concurrently with this case, sustained the Board of Tax

Appeals in holding the investment trusts there involved to be true trusts rather than associations taxable as corporations.

In this case, the Circuit Court of Appeals distinguished the petitioner from the trusts involved in the *Chase National Bank* cases on the ground that the petitioner was a business enterprise because, when additional Interests were created, bonds of issuers other than those theretofore included in the Trust could be deposited by the Depositor, whereas in the *Chase National Bank* cases, when additional Units were created, each such Unit was required to consist of exactly the same number of shares of exactly the same corporations as were included in each other Unit deposited in each of the trusts.

In neither of the prevailing opinions in this case in the Court below was resemblance to a corporation discussed or considered. Having determined, it is believed incorrectly, that the Board was in error in holding that the petitioner was not a business enterprise, the Court below reversed without considering the question of resemblance to a corporation in form and procedures.

Specification of Errors.

The Circuit Court of Appeals erred:

(1) in holding that the petitioner was, during the fiscal year ended August 31, 1936, an association taxable as a corporation;

(2) in upholding the contention of the Commissioner that the petitioner was engaged in or carrying on business during said fiscal year;

(3) in failing to hold that the petitioner did not resemble a corporation in form and procedures;

(4) in holding that the petitioner was engaged in a business enterprise because of the activities of the Depositor;

(5) in holding that the petitioner was engaged in a business enterprise because the nature of the investments underlying outstanding Certificates was changed upon the creation of additional Interests when bonds of issues other than those previously included in the trust res were deposited with the Trustee;

(6) in failing to hold that Article 801-2 of Regulations 86 was invalid and exceeded the power of the Commissioner to make regulations in so far as it purported to include in the term "association" a trust such as the petitioner;

(7) in failing to hold that the petitioner was a true trust and taxable as such; and

(8) in making independent findings of fact which are inconsistent with those made by the Board of Tax Appeals, though the findings of the Board are supported by substantial evidence.

Reasons for Granting the Writ.

1. In *Morrissey* v. *Commissioner, supra,* and its companion cases, *Swanson* v. *Commissioner,* 296 U. S. 362, *Helvering* v. *Combs,* 296 U. S. 365, and *Helvering* v. *Coleman-Gilbert Associates,* 296 U. S. 369, this Court established rules to be applied in determining what constitutes an association taxable as a corporation. Since the decision of those cases, there have been, in the Board of Tax Appeals, the District Courts and the Circuit Courts of Appeals, several scores of cases involving this same question, in all of which counsel for both sides have relied upon the above

cited cases, in support of their respective contentions and the decisions have been replete with references to the cases as authority for decisions both for and against the taxpayers.

Since the decision of the four cases above mentioned, the only occasion upon which this Court has considered any phase of the problem of associations taxable as corporations is *Lewis & Co.* v. *Commissioner*, 301 U. S. 385. While that case has not been, and is not, cited as frequently as the *Morrissey* case, it also is often relied upon by the attorneys on both sides of a case as supporting their contentions.

Under the circumstances, it is submitted that what constitutes an association taxable as a corporation is, within the meaning of subdivision 5 (b) of Rule 38 of the Rules of Practice of this Court, an important question of federal law which has not been, but should be, settled by this Court.

This Court has never considered the question whether a so-called investment trust is an association taxable as a corporation. It is a matter of general knowledge that several hundred million dollars are invested in such trusts in the United States. A careful review of the authorities discloses only seven cases in which the issue involved was whether investment trusts were associations taxable as corporations. These cases are: *Investment Trust of Mutual Investment Co.* v. *Commissioner*, 27 BTA 1322, aff'd per curiam 71 Fed. (2d) 1009; *Brooklyn Trust Co.* v. *Commissioner*, 80 Fed. (2d) 865; *Hamilton Depositors Corp.* v. *Nicholas*, 111 Fed. (2d) 385; *Continental Bank & Trust Co.* v. *U. S.*, 19 Fed. Supp. 15; *Equitable Trust Co.* v. *Magruder*, 37 Fed. Supp. 711; *Commissioner* v. *Chase National Bank, supra*; and the instant case.

In the first four cases above mentioned, the trusts involved were held to be associations taxable as corporations. In each of them the trustees had power to, and did, make sales of securities for the purpose of realizing profit and reinvested at least the original cost if not the whole proceeds of the sale of such securities, whereas in *Equitable Trust Co.* v. *Magruder* and *Chase National Bank* v. *Commissioner*, as in the instant case, the trustees could not make sales for the purpose of realizing a profit and when securities were sold or otherwise disposed of, the trustees were required to distribute the entire proceeds thereof among the investors. The decision of this case is accordingly in conflict with the rule apparently being established by the courts with respect to the taxable status of investment trusts, which makes the question whether or not the trust is an association primarily dependent upon whether or not the trustee may sell securities for the purpose of realizing a profit and reinvest the proceeds of such sales.

If it be urged that the question is not one of general importance because of the fact that most of the investment trusts such as the petitioner can and do qualify as "mutual investment companies" under Supplement Q (Sections 361 to 363) of the Internal Revenue Code, and hence pay no income tax with respect to the income which they distribute to their certificate holders, the answer is twofold:

(A) The definition of a mutual investment company in the Internal Revenue Code, if strictly construed, would prevent any investment trust from qualifying as a mutual investment company in any year in which it realized substantial capital losses.

(B) There is no assurance that these sections will

remain in the Code. The provisions were first enacted in the Revenue Act of 1936, were stricken by the Senate Finance Committee in its consideration of the House Bill which ultimately resulted in the Revenue Act of 1938 and were restored to the Act by the Conference Committee, *Seidman, Legislative History of Federal Income Tax Laws, page 101.* There is and can be no assurance that the Congress will continue the provisions in future Revenue Acts.

2. The decision of the Circuit Court of Appeals is in conflict with the decision of this Court in the *Morrissey* case. Under the *Morrissey* case, the entity to be taxable as an association must (a) resemble a corporation in form and procedures and (b) be engaged in, or have power to engage in, the conduct of a business enterprise. The petitioner does not resemble a corporation in form and procedures and neither engages in nor has power to engage in any business enterprise. The Board of Tax Appeals having determined that the petitioner was not a business enterprise, properly reversed the Commissioner's holding to the contrary without considering the question of corporate resemblance. The prevailing opinions in the Court below disagreed with the Board of Tax Appeals on this point and reversed without considering the question of corporate resemblance—either assuming it to exist or overlooking the fact that many admitted business enterprises, such as stock brokerage, law, accounting and engineering, are not usually conducted in corporate form, but as partnerships or sole proprietorships. If corporate resemblance does not exist, and it is submitted that it does not, the decision of the Court below is in conflict with the decision in the *Morrissey* case even if the majority in the Court

below were correct in holding that the petitioner was a business enterprise.

It is believed that the decision below also conflicts with the decision of this Court in the *Morrissey* case in that the test of business activity used in the majority opinions is in conflict with, and not sanctioned by, that decision of this Court. In the *Morrissey* case and its companion cases, this Court, in determining that the entities involved were business enterprises or had power to engage in business enterprises, examined the activities of the entities and the instruments under which they were created, not the activities of third parties which were independent taxpayers and whose activities took place outside the entities being examined. The activity which Judge Learned Hand considered determinative of the question was the activity of the Depositor, an independent taxpayer, in depositing additional bonds in the Trust in connection with the creation of new Interests during the taxable year.

3. The decision below is in conflict with the decision of this Court in *Lewis & Co.* v. *Commissioner*, *supra*, where, in holding that when real property was conveyed to a trustee vested with power to execute contracts, deeds, etc., in accordance with the directions of a real estate operator, no association existed, this Court said (pp. 388-9):

> "The duties of the trustee were purely ministerial, with no power to control, direct, or participate in, the conduct of the selling enterprise contemplated by the contract. There is to be found in the operation of the business no essential characteristic of corporate control—nothing analogous to a board of directors * * *."

The activities of the real estate operator in effecting sales of the real property certainly constituted the conduct of a business enterprise but they were activities conducted wholly outside of the trust and this Court did not refer them to the trust for the purpose of determining that the trust was engaged in a business enterprise. Conceding *arguendo* that the activities of the Depositor in the instant case in soliciting new grantor-beneficiaries and in selecting bonds for deposit in the Trust in connection with the creation of additional Interests constituted the conduct of a business enterprise, it is submitted that, under the *Lewis & Co.* case, they cannot be referred to the petitioner in order to hold that the petitioner was conducting a business enterprise and, accordingly, the decision below which has specifically done so is in conflict with the decision of this Court in the *Lewis & Co.* case.

4. The decision below is in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Commissioner* v. *Gibbs-Preyer Trusts*, 117 Fed. (2d) 619, in which case it was held that the trusts were not associations taxable as corporations even though, under the terms of the trust agreements, beneficiaries of the trusts managed the trust property.

5. The decision below is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit rendered on the same day in *Commissioner of Internal Revenue* v. *Chase National Bank, supra*, in which it held the four investment trusts there involved not to be associations taxable as corporations although additional Units of those trusts could have been created during the taxable year involved in that case. It is submitted that the distinction

made by the Court below, namely, that in the *Chase National Bank* cases the new Units must contain shares of stock of exactly the same corporations and in exactly the same numbers as those previously deposited, whereas the new Interests created in this case could contain bonds of different issuers from those previously in the Trust, is not a sound distinction upon which different legal effects should be based. In fact, in the brief for the Commissioner in the instant case in the Circuit Court of Appeals, the Attorney General himself said (p. 11):

> "Although the Commissioner maintains that the entities involved in this and the *Chase Bank* cases are sufficiently alike to be treated as identical for tax purposes, there are certain minor differences to be noticed."

In other words, the Commissioner would have been satisfied if all of the cases had been decided the same way and the Attorney General, acting as counsel for the Commissioner, could find only "minor differences" in the facts.

In establishing such a narrow distinction, the decisions of the Court below are in conflict with the spirit of the decision of this Court in *Helvering v. Coleman-Gilbert Associates, supra*, where, in discussing distinctions in formal procedure, this Court said (p. 373):

> "If such differences were to be made the test in determining whether or not an enterprise for the transaction of business constitutes an association, the subject would be enveloped in a cloud of uncertainty, and enterprises of the same essential character would be placed in different categories simply by reason of formal variations in mere procedural details."

In both the *Chase National Bank* cases and the instant case, once the property is deposited in the trust it cannot be changed by sale and reinvestment. It is submitted that if the question of whether or not such a trust is an association taxable as a corporation is to be determined on the basis of the nature of the property which may from time to time in the future be deposited in the trust, the question will indeed be enveloped in a cloud of uncertainty and enterprises of the same essential character—as are the trusts involved in these two cases—will be placed in different categories by reason of formal variations.

6. This Court has frequently held that under Section 8, Article I, of the Constitution, the power to make law cannot be delegated by Congress and that the power to make regulations conferred by the Revenue Acts upon the Commissioner is only power to adopt regulations to carry into effect the will of Congress as expressed by the statute. *Lynch* v. *Tilden Products Co.*, 265 U. S. 315, 320-322; *Miller* v. *U. S.*, 294 U. S. 435, 439-440; *Manhattan General Equipment Co.* v. *Commissioner*, 297 U. S. 129, 134-135.

The Commissioner ruled that the petitioner was not an association taxable as a corporation (R. 83-4). After promulgating amended regulations (Reg. 86, Art. 801-2) which include within the term associations, "an 'investment trust' (whether of the fixed or management type), * * * which is not, within the meaning of the Act, a trust * * *", without any amendment of the law by Congress, the Commissioner ruled that the petitioner was an association taxable as a corporation (R. 85-86). If, as is believed to be the case, Congress did not intend to include within the term "association" a trust such as

the petitioner, the amending of the regulations to include such a trust was an attempt by the Commissioner to amend the law and the Commissioner thereby exceeded his power and the regulation, in so far as it purports to include a trust such as the petitioner, is invalid and a mere nullity.

7. This Court has repeatedly held that the Board of Tax Appeals is vested with exclusive power to draw inferences and conclusions of fact from the evidence, and that the Circuit Court of Appeals is limited to determining (a) whether the Board applied the correct rule of law, and (b) whether there is substantial evidence to support the findings of the Board. *Helvering* v. *Rankin*, 295 U. S. 123; *Elmhurst Cemetery Co.* v. *Commissioner*, 300 U. S. 37; *Helvering* v. *Keogh*, 309 U. S. 277.

In *Tricou* v. *Helvering*, 68 Fed. (2d) 280, cert. den. 292 U. S. 655, the Circuit Court of Appeals for the Ninth Circuit said:

> "The Board of Tax Appeals sustained the Commissioner, holding that petitioner was not entitled to the deduction claimed for the reason that she was not engaged in any trade or business in the year 1922. This finding of the ultimate fact is binding upon us unless we can say that there is no substantial evidence to sustain it."

In *Commissioner* v. *Horseshoe Lease Syndicate*, 110 Fed. (2d) 748, cert. den. 311 U. S. 666, the Circuit Court of Appeals for the Fifth Circuit said:

> "The determination of this issue depends upon whether the syndicate, so organized and operated, resembles a corporation more nearly than it does

> a partnership, not being either exactly * * *. This is a question of fact, and the Board of Tax Appeals, under the stipulated facts, found that, for purposes of the income tax laws, the syndicate more nearly resembled a partnership. This finding must be upheld by this court if there is substantial evidence to support it, * * *."

It is submitted that the finding of the Board of Tax Appeals that the petitioner was not carrying on a business enterprise (R. 178) was a finding of an ultimate fact, supported by substantial evidence, and that, the Court below, in finding the petitioner to be a business enterprise (R. 210) departed from the rule established by this Court as to the binding effect of findings of fact made by the Board of Tax Appeals and that, accordingly, the case is one for certiorari under subdivision 5 (b) of Rule 38 of the Rules of this Court.

For the foregoing reasons, the petitioner respectfully prays that a writ of certiorari issue to review the decision below.

Respectfully submitted,

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